

DEPARTMENT OF INSURANCE
STATE OF LOUISIANA



PROCEDURAL REPORT
ISSUED MAY 4, 2011

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This document is produced by the Legislative Auditor, State of Louisiana, Post Office Box 94397, Baton Rouge, Louisiana 70804-9397 in accordance with Louisiana Revised Statute 24:513. Five copies of this public document were produced at an approximate cost of \$14.35. This material was produced in accordance with the standards for state agencies established pursuant to R.S. 43:31. This report is available on the Legislative Auditor's Web site at www.la.la.gov. When contacting the office, you may refer to Agency ID No. 3454 or Report ID No. 80110043 for additional information.

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Our procedures at the Louisiana Department of Insurance (department) for the period July 1, 2009, through April 4, 2011, disclosed the following:

- The department did not have an effective internal audit function.
- The finding identified in the prior year report on the department, dated May 24, 2010, relating to weaknesses in controls over the Insurance Premium Tax Suspense Fund has been resolved by management.
- No significant control deficiencies or errors relating to rate filings, producers licenses, claims adjuster licenses and registration, liquidation of insolvent insurers, insurance fraud investigations, Louisiana Insurance Rating assessments, premium taxes, and compliance with the Insurance Louisiana Incentive Program were identified.

This report is a public report and has been distributed to state officials. We appreciate the department's assistance in the successful completion of our work.

Department Profile

The department is a regulatory agency that operates primarily on self-generated revenue. In addition to collecting fees, assessments, and fines from regulated entities, the department collects premium taxes on behalf of the state general fund. Other department operating fund sources are federal grants and statutory dedications. Assessments on property/casualty insurance premiums also benefit Municipal Police Retirement, Fire Fighters Retirement, Sheriff's Pension and Relief Fund, and Municipal Fire and Police Civil Service.

Regulatory functions are performed by the Office of Property and Casualty, the Office of Health Insurance, the Office of Licensing and Compliance, the Office of Financial Solvency, the Office of Legal Services, and the Office of Receivership. In addition to performing licensing, policy form and rate regulation, the department responds to consumer inquiries and complaints against property and casualty, health, and life insurers and producers in these offices as well as in the Office of Consumer Advocacy and investigates insurance fraud.

The department provides staff for the Louisiana Property and Casualty Insurance Commission, the Louisiana Health Care Commission, the Louisiana Automobile Theft and Insurance Fraud Prevention Authority, and the Committee on Equal Opportunity. The department provides outreach services to Medicare beneficiaries through the federally funded Senior Health Insurance Information Program and through public presentations by the Office of Consumer Advocacy.

The mission of the department is to regulate the insurance industry in the state (licensing of producers, insurance adjusters, public adjusters and insurers) and to serve as advocate for the state's insurance consumers.

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LOUISIANA LEGISLATIVE AUDITOR
DARYL G. PURPERA, CPA, CFE

April 4, 2011

THE HONORABLE JAMES J. DONELON,
COMMISSIONER OF INSURANCE
DEPARTMENT OF INSURANCE
STATE OF LOUISIANA
Baton Rouge, Louisiana

As required by Louisiana Revised Statute 24:513, we conducted certain procedures at the Department of Insurance (department) for the period from July 1, 2009, through April 4, 2011.

- Our auditors obtained and documented a basic understanding of the department's operations and system of internal controls through inquiry, observation, and review of the department's policies and procedures documentation, including a review of the related laws and regulations applicable to the department.
- Our auditors performed analytical procedures consisting of a comparison of the most current and prior year financial activity using the department's annual fiscal reports and/or system-generated reports and obtained explanations from department management for any significant variances.
- Our auditors reviewed the status of the finding identified in the prior year report on the department, dated May 24, 2010, relating to weaknesses in controls over the Insurance Premium Tax Suspense Fund and determined that the finding has been resolved by management.
- Based on the documentation of the department's controls and our understanding of related laws and regulations, procedures were performed on selected controls and transactions relating to rate filings, producers licenses, claims adjuster licenses and registration, liquidation of insolvent insurers, insurance fraud investigations, Louisiana Insurance Rating assessments, premium taxes, and compliance with the Insurance Louisiana Incentive Program.

Based on the application of these procedures, we have reported a finding relating to an ineffective internal audit function. Besides this finding, we found no significant control deficiencies, noncompliance, or errors relating to our analytical procedures or our other procedures on the selected controls and transactions that should be communicated to management.

The following significant finding is included in this report for management's consideration:

Ineffective Internal Audit Function

The department did not have an effective internal audit function. The internal audit function should identify high risk areas and provide management with assurance that assets of the department are properly safeguarded; internal controls, including information technology controls, are established and operating in accordance with applicable laws and regulations; and procedures are sufficient to prevent or detect errors and/or fraud in a timely manner.

During the engagement, the following were noted about the internal audit function:

- The internal auditor identified 29 auditable areas in its three-year risk assessment plan. Internal audit assigns a rank to each identified area based on risk factors. Of the six audits and one follow-up audit issued since June 2007, there are several areas with a higher risk ranking not audited while other areas with lower risk rankings were audited. Risk analysis is an important part of an internal audit function, but that analysis must be followed by adequate internal audit procedures to address those risks identified.
- The scope of audits was not sufficient to constitute an effective internal audit function. The internal auditor issued two audits during fiscal year 2010 of which one audit, regarding Fraud and Louisiana Insurance Rating assessments, related to work done in fiscal year 2010. As of January 19, 2011, the internal auditor has issued one audit during fiscal year 2011, regarding property control.

Considering the department's reported assets over \$143 million and reported revenues over \$457 million at June 30, 2010, an effective internal audit function is needed to ensure that the department's assets are safeguarded and that management's policies and procedures are uniformly applied. The lack of sufficient progress toward addressing the higher ranked risk areas diminishes the department's ability to identify and address material weaknesses that could result in loss of assets, errors going undetected, fraud, and/or improper accounting and reporting of department funds.

The department should ensure that internal audit is effectively planning audits and devoting the time and effort to effectively address and report on the higher risk areas identified in the audit plan that will better ensure management's policies and procedures are followed in these areas. Management concurred with the finding and provided a corrective action plan (see Appendix A).

The recommendation in this report represents, in our judgment, that most likely to bring about beneficial improvements to the operations of the department. The varying nature of the

recommendation, its implementation cost, and its potential impact on the operations of the department should be considered in reaching decisions on courses of action.

Our procedures were more limited than would be necessary to give an opinion on internal control and on compliance with laws, regulations, policies, and procedures governing financial activities.

The Annual Fiscal Report of the department was not audited or reviewed by us, and, accordingly, we do not express an opinion on that report. The department's accounts are an integral part of the State of Louisiana's financial statements, upon which the Louisiana Legislative Auditor expresses opinions.

This report is intended for the information and use of the department and its management and the Louisiana Legislature and is not intended to be, and should not be, used by anyone other than these specified parties. Under Louisiana Revised Statute 24:513, this report is distributed by the Legislative Auditor as a public document.

Respectfully submitted,

A handwritten signature in blue ink, appearing to read "Daryl G. Purpera".

Daryl G. Purpera, CPA, CFE
Legislative Auditor

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Management's Corrective Action
Plan and Response to the
Finding and Recommendation



LOUISIANA DEPARTMENT OF INSURANCE

JAMES J. DONELON
COMMISSIONER

February 2, 2011

The Honorable Daryl Purpera
Legislative Auditor
Office of the Louisiana Legislative Auditor
P.O. Box 94397
Baton Rouge, LA 70804

RE: Legislative Auditor Finding of Ineffective Internal Audit Function

Dear Mr. Purpera:

The Louisiana Department of Insurance (LDI) accepts your finding that the internal audit functions performed by the internal auditor have been insufficiently effective. The LDI management relied on allowing the internal auditor a functional independence to permit full, unfettered review of department activities and procedures that resulted, in hindsight, in insufficient supervision of the internal auditor's activities.

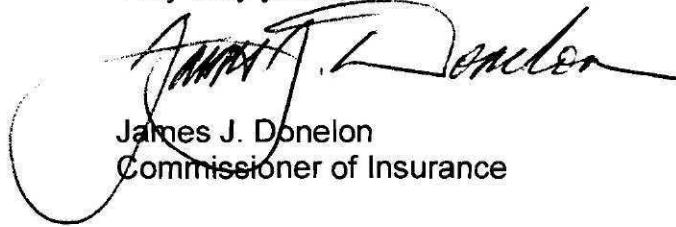
In anticipation of the current internal auditor's retirement in May 2011, the LDI has hired an Auditor 3 to assume the internal audit functions. This employee has demonstrated an eagerness to perform in this area and comes to the position with strong credentials from the LDI Office of Financial Solvency. She entered state service as an Accountant 1 in 2005 and joined the LDI in April 2006. She holds professional designations of Certified Financial Services Auditor and Certified Financial Examiner, and is currently pursuing the Certified Internal Auditor designation.

While the LDI management remains committed to allowing the new internal auditor independence in her activities, the LDI is committed to improved accountability in terms of greater sufficiency and efficiency. As of FY 2010-2011, the LDI upgraded the performance indicator #6393 from general data to a supporting indicator with a performance standard of four internal audits performed each year. By using the supporting indicator format, semi-annual performance targets will be created, and performance will be evaluated on a regular basis. Management is committed to providing more supervision without interfering in the internal auditor's independence.

The LDI assures that we maintain high levels of internal controls beyond the safeguards provided by an internal auditor function. These safeguards have been disclosed to the legislative auditor in the LDI's February 2, 2011, procedural review engagement response. The management and staff of the LDI consistently demonstrate a strong commitment and high level of vigilance to assure accurate reporting, as well as the prevention and detection of errors and fraud.

With best wishes and kindest personal regards, I remain

Very truly yours,

A handwritten signature in black ink, appearing to read "James J. Donelon", written over a large, loopy circular flourish.

James J. Donelon
Commissioner of Insurance

JJD/ShDB:dtd

JJD-FEB2011.2879